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## Grocery Outlet Bargain Market I

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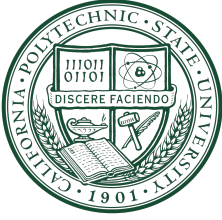
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## Grocery Outlet Bargain Market

What do you look for in a grocery store? Is it the friendly employees? Store location? Name brand items? Or is it the consistently low prices? For many American families the answer is low food prices. In 2014, middle class families spent an average of \$5,992 on food, representing 13.4 percent of their yearly income. The lowest income households spent \$3,667 on food, representing 34.1 percent of their yearly income (**See Exhibit 1**).<sup>1</sup> Grocery Outlet Bargain Market is the leading extreme value food retailer. They are truly unique and successful because of their strong relationships with producers, their connection to the community through independent operators, and their ability to have the lowest food prices around.

Over the last ten years Grocery Outlet Bargain Market has experienced a significant amount of growth and success. This success can be attributed to many different factors. However, the key to this success is maintaining and creating relationships with major producers across the United States and the world. Grocery Outlet buyers look for opportunities all over the world. Some will travel thousands of miles each year to find the best deals available. These mutually beneficial relationships are unique in the food retail industry. There is no longer a middleman. The buyers are purchasing food products opportunistically via events like packaging changes, product overruns, and surplus inventories.<sup>2</sup>

Headquartered in Emeryville, California, Grocery Outlet has been family operated for almost 70 years and has a rich history of putting customers and employees first. Grocery Outlet generates annual revenues exceeding \$1.5 Billion and employs around 1000 people across the United States.<sup>3</sup> With overall food CPI on the rise grocery outlet expects more growth over the next few years **(See Exhibit 4)**.<sup>1</sup>

## **Company History:<sup>4</sup>**

On a foggy San Francisco night, Jim Read thought to himself what could I do to give people canned food at an affordable price. Jim Read started “Cannery Sales” in San Francisco in 1946. It began by Mr. Read purchasing government surplus food and selling the surplus in vacant stores. This type of maximization of resources became the backbone model of the company to help its customer get the most possible savings.

In 1959, Mr. Read acquired interest in “Big Bonus Foods,” a ten-store Bay Area chain. In 1970, Mr. Read acquired Globe of California. In 1971, the first supplier agreement was signed with Del Monte and the first independent operator agreement was signed and opened in Redmond, Oregon. In 1982, Jim Read’s sons, Peter and Steven, took over ownership following Jim’s passing. During Peter and Steven’s ownership, the company grew to over 100 stores and expanded inventory to a deli, frozen food, and fresh produce departments.

In 2001, the company acquired inventories from Webvan and wine.com from bankruptcy. In 2002, the corporate name was changed to Grocery Outlet Incorporated. The year 2006 marked the passing to the third generation of Read family as MacGregor Read and Eric Lindberg were appointed co-CEOs. This year also marked the beginning of a period of significant growth.

In 2009, Berkshire Partners acquired a majority interest Grocery Outlet. In 2011, Grocery Outlet acquired Amelia’s in Pennsylvania, which helped the company expand to the East Coast. Grocery Outlet introduced Lois Prices as the company spokes puppet with her band of Frugal Friends. This year also marked the milestone of \$1 billion sales for Grocery Outlet. In 2014, Hellman and Friedman bought the controlling interest of Grocery Outlet.

## **Industry Background:**

According to IBISWorld, domestic Supermarkets and grocery stores are approximately a \$593 billion industry, employing over 2.5 million. The industry has grown one percent per year from 2011-2016<sup>5</sup> **(See Exhibit 2)**. In the last seven years,

demand for organic and natural foods have increased the popularity of specialty stores. The factors that drive revenue growth for grocery stores are consumer spending habits and food trends. The demand for supermarkets and grocery stores are driven by population growth and consumer tastes. The margins for the industry are quite small, so profits are driven by volume and efficiency of operations. The industry is concentrated as the 50 largest companies generate approximately 70 percent of the revenue.

A typical supermarket or grocery store offers a range of food items that typically include meat, produce, dairy, and frozen food as well as non-food items that include health and beauty products, general merchandise, and medication. Grocery stores are organized to put similar items into aisles as well as different departments. It is important for the supermarket and grocery stores to have effective supply chain management to minimize costs. Supply chain management refers to the movement and storage of raw materials, work-in-progress inventory, and finished goods.

In the supply chain, grocery stores have distribution centers as well as truck fleets or have to outsource transportation. Another major step in the supply chain is category management, where the stores have to maximize storage space for items while minimizing spoilage for the perishable products. Due to the large volume of product that passes through stores, the technology needs to be up to date to track and catalog all the items. Computerized informational systems help stores and retailers track and analyze data to give an understanding of consumer preferences.

Marketing is an important tool to help drive sales in the grocery store industry. With the amount of competition rising, it is important to differentiate from the competition. The typical forms of advertising are newspaper, television, radio, mail, and in-store promotions. The growth of technology has also expanded the forms of advertising to Internet sites and social media. According to Food Market Institute, the demographic for grocery store customers are female head of households.<sup>6</sup>

## **Business Overview:**

Grocery Outlet Bargain Market operates in what some would say is a niche market. They are the extreme value retailer with competition in the Northwest, with WindCo and in the Los Angeles market with Aldi's. WindCo has more SKUs than Grocery Outlet and has similar prices, which poses a threat to Grocery Outlet, and Aldi's is of similar size as Grocery Outlet and has similar prices. Other stores that pose a threat to Grocery Outlet are Wal-Mart and Food 4 Less for their low prices. Grocery Outlet has 299 stores, which are mostly on the west coast, but they do have 18 stores in Pennsylvania.

When shopping at Grocery Outlet, consumers can expect a 40-70 percent savings versus a traditional grocery. Each Grocery Outlet store is about 14,500 square feet with about 4,500 SKUs. Grocery Outlet looks to maximize their sales per square foot and is one of the most efficient at doing so. Grocery Outlet keeps in good relations with the producers by paying the bills on time and making transactions hassle free. They do business with thousands of suppliers each year and are always trying to maintain and grow the relationship. In order to meet with new potential suppliers, Grocery Outlet will attend food trade shows and sometimes “cold call” suppliers.

## **Marketing:**

When people think of Grocery Outlet and their marketing plan, many sing to themselves, “Grocery Outlet, Bargain Market.” This jingle plays on radio stations, television commercials and in store announcements to remind people what Grocery Outlet truly is, a bargain market. The jingle was initially released in 2006 when they rebranded to Grocery Outlet, this year marks the first year of significant growth. During in store commercials, consumers are able to hear the lowest prices Grocery Outlet is offering that day.

Also, as of recently Grocery Outlet has introduced WOW Alerts, NOSH and their spokespeople, the Frugal Friends. WOW Alerts are alerts people receive in a weekly or daily subscribed to newsletter. In these newsletters, consumers hear the “hottest deals” in stores. According to Jeff Phillips, Director of Strategy for Grocery Outlet, in a recent interview he said that Grocery Outlet has seen an increase in the sales of those products being advertised on the WOW Alerts. He also claimed that this is a recent win for driving people back into stores.

Since the introduction of NOSH, Natural-Organic-Specialty-Health, Grocery Outlet has been able to directly market to the evolving consumer demand. In the new health conscious era, more and more are people worried about the products they are putting into their bodies. Having a specific sector of all Grocery Outlet stores as NOSH, has helped drive more people back to stores because they know that they will be able to get “NOSH” products at low prices.

Grocery Outlet has also introduced their spokespeople, The Frugal Friends: Lois Prices, Ben Saven, Tammy Underspend and Doug - the guitarist (**see Exhibit 2**). These fun loving puppets appear in television commercials and are used as a way to connect with families, the everyday consumers and all fun loving individuals. The commercials they star in usually entail explaining different aspects of Grocery Outlet. For example,

one commercial explains how Grocery Outlet is able to achieve such low prices all under 30 seconds and in an entertaining song. These puppets are also used in stores as a way to announce deals.<sup>7</sup>

Lastly, Grocery Outlet uses Facebook for marketing. They have a general Facebook for the company and each individual store has their own Grocery Outlet Facebook. This allows people to connect with what the company is doing as a whole but also to their own local Grocery Outlet.

## **Distinguishing Traits:**

Grocery Outlet has two distinguishing traits that separate them from their competition. These two factors: opportunistic buying and independent operators are crucial to how their business operates and continues to flourish.

### **Opportunistic Buying:**

The purchasing model of what is known as “opportunistic buying” really makes Grocery Outlet Bargain Market who they are. How the model works is Grocery Outlet buys excess inventory from a producer that would otherwise be discarded or donated and gets the product for dimes on the dollar. Grocery Outlet does benefit from producers having issues in the supply chain. If an order is cancelled from a producer or if they produce more than they expected to sell to a traditional grocery store, Grocery Outlet is there to pick up the excess. This large amount of savings can then be passed onto the customer where savings of up to 70 percent can be found.

When entering a Grocery Outlet store every product has a price tag with two prices, one for the Grocery Outlet price and one for the industry average. The price tag also shows the percentage savings on the product, which often vary from 40-70 percent savings from the industry average. This allows the customer to really stretch their dollar and get more “bang for their buck” when shopping at Grocery Outlet. This model presents a rare “win-win-win” situation: the producer wins because they get money for inventory that would otherwise go to waste, Grocery Outlet wins because they make a profit, and the consumer wins because they get great deals on various products.

The model does have some downsides that come with it. Many of the products are perishable and they have a best before date that the customer is recommended to consume the product by, but some of the items in Grocery Outlet are passed their best before date. This is because they do not receive the inventory from the producer till late in the supply chain. Although Grocery Outlet pulls products that are considered unsafe to eat, it does

scare of customers seeing products that are passed their best before date. The Director of Strategy, Jeff Phillips, reassured that Grocery Outlet has never faced any major food safety concerns.

Another problem with the model is Grocery Outlet has to worry about turning their perishable inventory quickly. Due to Grocery Outlet getting product later in the supply chain these perishable products have a lower average shelf life than those in a traditional grocery store. Due to Grocery Outlet buying product only when producers have excess inventory, this leads to little product consistency. If an item is in stock one week, the next week it could not be available because there was no excess from the producer. If a product is selling quickly each week, the law of supply and demand would typically take place and the store would raise the price of that item, but Grocery Outlet does not want to take advantage of their customers and will keep their prices as low as possible.

### **Independent Operator:**

Another component that sets Grocery Outlet apart from the competition is their independent operators. The independent operators are the individual storeowners who select, order, and merchandise products, as well as hire, train, and pay employees. Grocery Outlet is not a franchise; it is a consignment agreement. This agreement allows the independent operator to take product from the consignment stock for resale, subject to repayment to the company. This allows the independent operator to not have to put up large amounts of money to purchase the stores inventory. The entire purchasing process for the independent operator is computerized, where they have their options of product on a computer and can choose what their individual stores need based on consumer preference. Once the products are sold, the independent operators repay the cost of goods sold, and split the profits with corporate 50-50. To become an independent operator it currently costs approximately \$200,000, which is about ten percent of the price to open a store and corporate covers the rest.

Grocery Outlet looks for families to become independent operators because it is a family business. Ryan and Shannon Parrish, the independent operators of the San Luis Obispo Grocery Outlet, find the benefit of being apart of a family operation, as they spend a lot more time with their family, can choose their hours, and allows their children to work in the store along side them. This also allows the operators to become apart of the local community where their respective store is. The benefits of this include knowing the customers needs and trends and it makes shopping at Grocery Outlet a personal experience. The CEO of Grocery Outlet, Eric Lindberg, compared being an independent

operator to throwing a party everyday, the operator is in charge with the setup and has to clean up and start new everyday.

Being an independent operator does have the luxury of being your own boss, but it comes at the cost of a lot of hard work. It is a seven-day workweek for the typical independent operator and if they are not committed, then the store will fall apart. The interview process is a lengthy process to become an independent operator. According to Ryan and Shannon Parrish there were 3,500 applicants where only 50 of those made it to become independent operators. This allows Grocery Outlet to select the cream of the crop to be the faces of their business. In the case of Ryan and Shannon Parish, they have combined over 40 years of experience in food retail and made it all the way through this drawn out process and are currently running a profitable store.

## **Company Growth:**

### **Growth From the Start:**

Grocery Outlet has been full-speed ahead in terms of growth ever since its inception. This upward trend has been evident in recent years as sales increased from just \$100 million dollars in 1984 to \$1 billion dollars in 2011. Although sales increased ten-fold during the 27 year period, Eric Lindberg considers 2006 to 2016 to be the period of most growth for the company. When MacGregor Read and Eric Lindberg took on the roles of co-CEO in 2006, Grocery Outlet was operating 100 stores in five different states on the West coast.

Lindberg attributes some of the company's growth to the addition of a fresh meats department, which was included in Grocery Outlet's growling lists of services offered in 2006. This new addition helped expand their services and start what would later become NOSH, a new initiative for Natural, Organic, Specialty, and Healthy foods. The NOSH program is essential for Grocery Outlet to operate in a market with a high demand for fresh, healthy foods, such as produce and meats. Grocery Outlet has been able to thrive as a result of its ability to adapt to consumer preference.

### **Acquisitions:**

Shortly after opening the fresh meats department, Grocery Outlet's growth was noticed by private equity firm Berkshire Partners, who acquired them in 2009. The Boston-based private equity firm has been operating in over 100 companies since 1986. Under Berkshire's ownership, Grocery Outlet would continue to thrive and grow in both size and scope. The company would hold monthly executive team meetings in order to



develop good questions to push thinking forward. If Grocery Outlet wanted to continue growing, it would need to be viewed from different perspectives. For example, the shareholders strongly believe in investing in the independent operators. If the investors help drive the independent operators' sales, then everyone benefits. In 2011, Grocery Outlet acquired Pennsylvania-based rival, Amelia's, increasing their store count to over 230 stores in six different states. Today, there are more than 299 locations in California, Oregon, Washington, Idaho, Nevada, and Pennsylvania. Although Berkshire Partners was thrilled with the results produced by Grocery Outlet, the private equity firm eventually sold off its share to another firm, Hellman & Friedman, in 2014.<sup>8</sup>

## **Challenges:**

After an interview with Jeff Phillips he explained some challenges Grocery Outlet faces on a daily basis.

### **Delivering consistent products to consumer:**

Since Grocery Outlet buys excess inventory from producers some products may not always be in store and consumers can be faced with an inconsistency in products. Also, because Grocery Outlet buys this excess inventory for dimes on the dollar, they sell it cheap and can result in products being purchased quickly. When a traditional grocery store is inconsistent with products consumers are easily frustrated and may result in not returning to the store. At Grocery Outlet this is something that consumers must keep in mind as Grocery Outlet relays their savings from the producer to them. This may also be a result of another problem.

### **Educating consumers on their model:**

Because Grocery Outlet operates in a different sector of grocery stores, consumers must know how their model works. When one thinks of Grocery Outlet they may think lower prices equals lower quality. That is the stereotype Grocery Outlet faces on a daily basis and is looking to overcome. Once consumers know that Grocery Outlet buys excess products from suppliers, they can understand that products can be sold cheap, but may have inconsistency problems and can be labeled differently. This does not mean the products are of lower quality, but that they could not sell and Grocery Outlet has found a solution to bring excess goods to consumers at the lowest possible prices. Also, like a traditional grocery store, Grocery Outlet carries staple goods, or your everyday products such as milk, eggs and bread; this allows consumers to shop as if they were at a traditional grocery store. Educating consumers on their model is a key for future success because it will allow the consumers to get the most out of Grocery Outlet.

### **Money Spent on Marketing:**

When persons take the leap to become an independent operator it comes with a hefty initial investment. Being one's own boss can be crazy at times, but in the end it always has its upside. Since independent operators are usually putting forth all of their effort into their store, the marketing for each individual store can get overlooked at times. Because each individual store has different consumer preferences and demographics, each store must convey a specific marketing plan. Keeping in mind that store owners are trying to already juggle a store, marketing can be put on the back burner waiting to be put into use. But like mentioned before, Grocery Outlet as a whole, is trying to market to consumers using their Frugal Friends, WOW Alerts and NOSH.

### **Issues with Human Resources:**

Another challenge that the independent operators face is problems with human resources. Due to the independent operators having various backgrounds and every one is unique, it can be difficult to follow the same rules and regulations regarding human resources. Ryan and Shannon Parrish stated that some of the biggest challenges they face are administrative related, although they are their own boss, they do have to obey Grocery Outlet policies and it is difficult to have hundreds of different operators uniformly following the same guidelines. The operators do treat each other like family and are standing by the phone to help their fellow operators with any issue that they have with employee relations.

### **Future Options:**

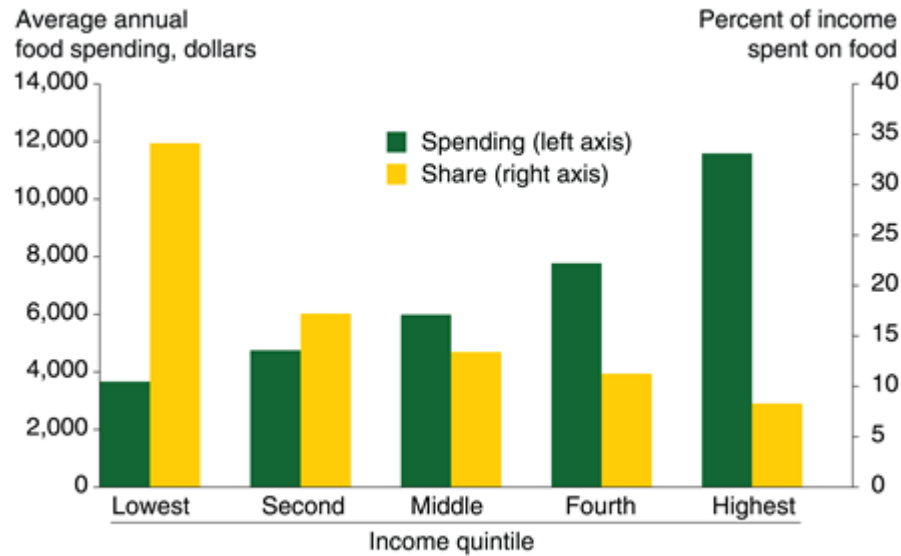
The future for Grocery Outlet is a bright one, as Jeff Phillips contemplates how the company wants to move forward. Overall, the core model will not change. Phillips wants to maintain the focus on opportunistic products and independent operators going forward since they have both served the company well and are foundations for future growth. Over the next ten years, Phillips expects growth to continue with the introduction of smaller store formats, as well as exploration of new geographic markets.

There will always be barriers to entry when entering new markets, and Los Angeles is no exception. It is one of the most competitive food retail markets in the nation. While Grocery Outlet's business model is unique, it is not alone in the retail landscape. As stated earlier, Aldi's is a much larger competitor in extreme value retail with a focus on the Los Angeles market. While some may see this as a deterrent, others see this as an opportunity to shake up the market and gain insight.

Although he wants the company to grow, Phillips also wants stores to be more efficient with the space they are given. One method of accomplishing this is through smaller stores. Most supermarket chains are limited when it come to space since there are very few options in urban areas, where adequate food retail space is often both expensive and difficult to find. The lack of stores has led to the market being occupied by convenience stores and similar formats. Introducing smaller stores will increase efficiency and give Grocery Outlet a huge opportunity to enter new markets. The company's cost-effective sourcing model keeps inventory costs at a minimum, allowing stores to carry more with less at risk.

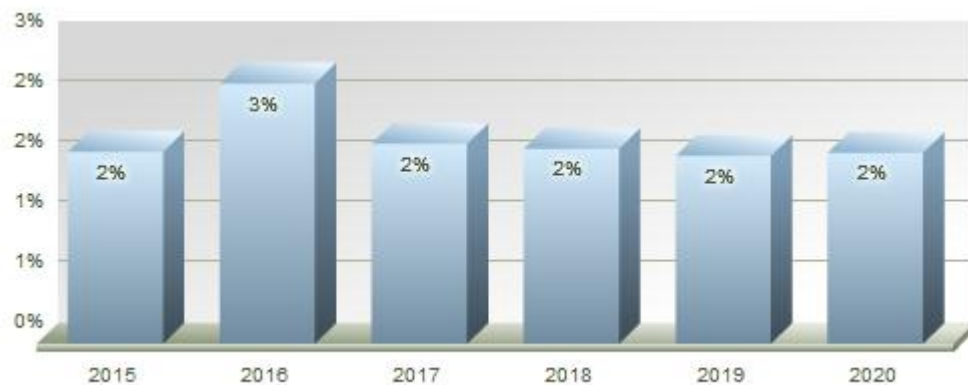
### Exhibit 1:

#### Food spending and share of income spent on food across U.S. households, 2014



Source: USDA, Economic Research Service using data from U.S. Bureau of Labor Statistics, Consumer Expenditure Survey, 2014.

### Exhibit 2:



“US personal consumption expenditures at grocery stores and supermarkets are forecast to grow at an annual compounded rate of 2% between 2016 and 2020.”

### Exhibit 3:

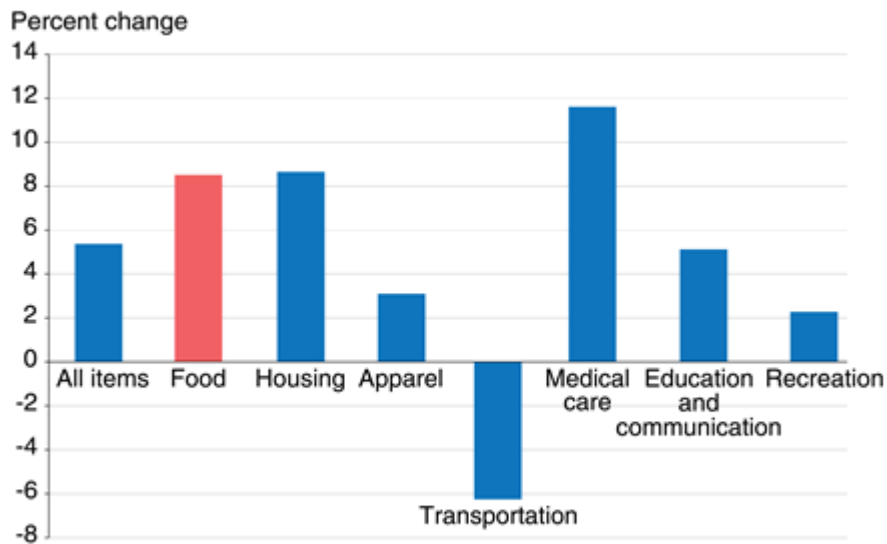


*Starting from the left: Tammy Underspend, Ben Saven, Lois Prices, and Doug - the guitarist*

*Source: "Meet the Frugal Friends - Grocery Outlet." Grocery Outlet. N.p., n.d. Web. 06 June 2016.*

### Exhibit 4:

#### Percent change in major CPI categories, 2011-15



Source: USDA, Economic Research Service using data from the U.S. Bureau of Labor Statistics.

**Exhibit 5:**



*Pictured above (left to right): Mitchell Comstock, Lukas Oswald, Michael Maggipinto, and Eric Lindberg.*

## Endnotes:

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<sup>1</sup> "USDA ERS - Food Prices and Spending." *USDA ERS - Food Prices and Spending*. N.p., n.d. Web. 06 June 2016.

<sup>2</sup> "Our Company - Grocery Outlet." *Grocery Outlet*. N.p., n.d. Web. 06 June 2016.

<sup>3</sup> "LinkedIn Grocery Outlet." N.p., n.d. Web.

<sup>4</sup> "History and Milestones - Grocery Outlet." *Grocery Outlet*. N.p., n.d. Web. 06 June 2016.

<sup>5</sup> "Supermarkets & Grocery Stores in the US: Market Research Report." *Supermarkets & Grocery Stores in the US Market Research*. N.p., n.d. Web. 06 June 2016.

<sup>6</sup> "Grocery Stores & Supermarkets - Quarterly Update 5/4/2015." *First Research Industry Profiles*, (2015)

<sup>7</sup> "Meet the Frugal Friends - Grocery Outlet." *Grocery Outlet*. N.p., n.d. Web. 06 June 2016.

<sup>8</sup> "Hellman & Friedman Completes Grocery Outlet Acquisition." *Berkshire Partners*. N.p., 7 Oct. 2014. Web. 06 June 2016.